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UNCLAS SECTION 01 OF 04 BRASILIA 001142

SIPDIS

SENSITIVE

STATE PLEASE PASS TO USTR FOR SCRININ
DEPT OF TREASURY FOR FPARODI
USDOC FOR 3134/USFCS/OIO/WH/EOLSON
USDOC FOR 4332/ITA/MAC/WH/OLAC/MWARD
USDA FOR FAS/ITP AND FAS/FAA/WH
STATE PASS OPIC FOR MORONESE, RIVERA, MERVENNE
STATE PASS EXIM FOR NATALIE WEISS, COCONNER
STATE PASS USTDA FOR AMCKINNEY

E.O. 12958: N/A

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SUBJECT: SLOW GROWTH IN US EXPORTS TO BRAZIL

REF: BRASILIA 682

1. (U) THIS IS A JOINT STATE/FCS MESSAGE; IT INCLUDES INPUT FROM AMCONSULATES SAO PAULO AND RIO DE JANEIRO. UNLESS OTHERWISE SPECIFIED, DISCUSSION OF U.S. EXPORT TOTALS IS BASED UPON USDOC, NOT GOB, DATA.

2. (SBU) SUMMARY AND INTRODUCTION. OVER THE PAST DECADE GROWTH IN U.S. EXPORTS TO BRAZIL HAS STAGNATED, WITH THE TOTAL OSCILLATING AROUND THE USD 11 TO 13 BILLION LEVEL. THE GOOD NEWS, HOWEVER, IS THAT, AT LEAST FROM 1992-2001, EXPORTS TO BRAZIL FROM U.S. SMALL AND MEDIUM-SIZED ENTERPRISES HAVE INCREASED IN VALUE SUBSTANTIALLY (242 PERCENT). BASED UPON OUR CONTACTS WITH POTENTIAL EXPORTERS AND A REVIEW OF THE DATA, POST BELIEVES THAT THE SPOTTY PERFORMANCE OF U.S. EXPORTS OVERALL REFLECTS: A) THE INABILITY OF THE BRAZILIAN ECONOMY TO EXPAND IN A SUSTAINABLE FASHION, B) THE TEN-YEAR DECLINE IN THE VALUE OF THE BRAZILIAN REAL VERSUS THE USD, AND C) THE DIFFICULTIES U.S. EXPORTERS FACE (I.E., LACK OF KNOWLEDGE, ARCANE IMPORT REGULATORY REGIME, AND INADEQUATE PORT INFRASTRUCTURE) IN ENTERING THE BRAZILIAN MARKET. MORE WORRISOME, WHILE IN 2004 U.S. EXPORTS TO BRAZIL INCREASED 23.6 PERCENT, THE U.S. MARKET SHARE OF BRAZILIAN IMPORTS DECLINED TO 18 PERCENT, INDICATING THAT THE U.S. IS LOSING GROUND COMPARED TO OTHER COUNTRIES.

3. (U) ALL THIS IS AGAINST THE BACKGROUND OF DECLINING GOB NORMAL-TRADE-RELATIONS (NTR) TARIFFS OVER THE PAST TEN YEARS. RECENT STATEMENTS BY PRESIDENT LULA THAT HE IS CONSIDERING PROMOTING GREATER IMPORTS TO BRAZIL PROBABLY ARE INTENDED MORE TO PRESSURE DOMESTIC INDUSTRY TO KEEP PRICES IN CHECK RATHER THAN TO SIGNAL ANY UPCOMING IMPORT-FRIENDLY POLICY. INDEED, ONE OF THE DRIVING FORCES BEHIND BRAZIL'S RECENT RESURGENCE IN INTERNATIONAL FINANCIAL MARKETS HAS BEEN ITS ABILITY TO POST STRONG TRADE AND CURRENT ACCOUNT SURPLUSES. END SUMMARY AND INTRODUCTION.

4. (U) WITH A GROSS DOMESTIC PRODUCT OF NEARLY US\$600 BILLION, BRAZIL REPRESENTS ABOUT HALF OF SOUTH AMERICA'S POPULATION, TERRITORY, AND ECONOMY. IN 2004, BRAZIL IMPORTED US\$62.8 BILLION IN PRODUCTS, THE VAST MAJORITY OF WHICH WERE INDUSTRIAL AND MANUFACTURED GOODS. (BRAZIL IS A HIGHLY COMPETITIVE PRODUCER OF AGRICULTURAL COMMODITIES AND A MAJOR FORCE IN THE AG EXPORT MARKET.) LAST YEAR, ESTIMATED U.S. EXPORTS TO BRAZIL WERE US\$13.86 BILLION AND BRAZILIAN EXPORTS TO THE UNITED STATES REACHED US\$20 BILLION. THIS US\$13.86 BILLION FIGURE REPRESENTS A 23.6 PERCENT INCREASE OVER THE U.S. EXPORT TOTAL FOR 2003 - US\$ 11.218 BILLION - BUT IS SUBSTANTIALLY LOWER THAN THE PEAK LEVEL OF US\$15.928 BILLION IN 2001 AND MORE OR LESS EQUIVALENT TO THE EXPORT TOTAL FOR 1999, US\$13.249 BILLION. SEE TABLE 1 BELOW.

TABLE 1

US EXPORTS TO BRASIL, 1994 TO 2004
(IN BILLIONS OF US\$)

1994	1995	1996	1997	1998	
8.118	11.443	12.699	15.912	15.157	
1999	2000	2001	2002	2003	2004
13.249	15.359	15.928	12.408	11.218	13.863

ALTHOUGH DISCERNING A CLEAR TREND FROM THE ABOVE FIGURES IS DIFFICULT, IT WOULD APPEAR THAT BOTH STRONG GDP GROWTH AND A STABLE EXCHANGE RATE -- AS WAS THE CASE IN 1995, 1997, 2000 AND 2004 -- ARE ESSENTIAL TO U.S. EXPORT GROWTH. (TABLE 2 BELOW SETS FORTH EXCHANGE RATE AND GDP GROWTH DATA OVER THE SAME PERIOD.)

TABLE 2

BRAZIL GDP AND AVERAGE ANNUAL EXCHANGE RATES, 1994 TO 2004

	1994	1995	1996	1997	1998
GDP GROWTH	5.9%	4.2%	2.7%	3.3%	0.1%
E/R VERSUS USD	.85	.97	1.04	1.12	1.21
1999	2000	2001	2002	2003	2004
0.8%	4.4%	1.3%	1.9%	0.5%	5.2%
1.79	1.96	2.32	3.53	2.89	2.93

15. (U) THIS UP-AND-DOWN PERFORMANCE ON EXPORTS COMES AGAINST A BACKGROUND OF STEADILY DECLINING IMPORT TARIFFS. BETWEEN 1994 AND 2003, AVERAGE BRAZILIAN N-T-R TARIFFS DECLINED FROM 14.38 PERCENT (MEDIAN 20 PERCENT) TO 10.83 PERCENT (MEDIAN 13 PERCENT). MEANWHILE, PER TABLES 3 AND 4 BELOW, IN 2004 THE U.S. MARKET SHARE OF BRAZILIAN IMPORTS HAS DECLINED TO 18 PERCENT (GOB MINISTRY OF DEVELOPMENT INDUSTRY AND COMMERCE FIGURES), INDICATING THAT THE OVERALL LEVEL OF U.S. EXPORTS IS NOT ONLY LEVELING OFF BUT THAT THE U.S. IS LOSING GROUND COMPARED TO FOREIGN COMPETITORS, PRINCIPALLY, ASIA.

TABLE 3

PERCENTAGE MARKET SHARE OF U.S. IMPORTS (FOB)

1994	1995	1996	1997	1998	
20%	21%	22%	23%	23%	
1999	2000	2001	2002	2003	2004
24%	23%	23%	22%	20%	18%

TABLE 4

INROADS INTO IMPORT MARKET BY FOREIGN COMPETITORS* (FOB)

	1998	1999	2000	2001	2002	2003	2004
ASIA	13%	13%	15%	16%	17%	18%	20%
AFRICA	3%	5%	5%	6%	6%	7%	9%

*PERCENTAGE MARKET SHARE

16. (U) A REVIEW OF THE MINISTRY'S IMPORT STATISTICS FOR 2004 PROVIDES A FEW SNAPSHOTS OF THE DEGREE TO WHICH FOREIGN COUNTRIES ARE GAINING GROUND IN THE BRAZILIAN MARKET. FOR EXAMPLE, IN 2004 THE U.S. WAS THE FOURTH LEADING SUPPLIER OF AUTO PARTS, TRAILING GERMANY, ARGENTINA, AND JAPAN. HOWEVER, WHILE U.S. EXPORTS FOR 2004 INCREASED A HEALTHY 32 PERCENT, THOSE OF ARGENTINA (65.56%) AND JAPAN (42.8%) INCREASED EVEN MORE. THE SAME PHENOMENON OCCURRED WITH INTEGRATED CIRCUITS, WHERE THE UNITED STATES IS THE SECOND LEADING SUPPLIER, BEHIND SOUTH KOREA BUT AHEAD OF TAIWAN. YET, SOUTH KOREAN EXPORTS ROSE 64.72%, TAIWANESE EXPORTS 96.94 PERCENT, AND U.S. EXPORTS ONLY 18.22%. PHARMACEUTICALS TELL A SIMILAR STORY. THE U.S. LEADS SWITZERLAND IN THIS CATEGORY, THOUGH U.S. EXPORTS ROSE 12.46% WHILE SWISS EXPORTS ROSE 16.16%. THE GOOD NEWS, HOWEVER, IS THAT IN THOSE CATEGORIES IN WHICH THE U.S. HELD A COMMANDING MARKET SHARE, INTER ALIA, AVIATION MOTORS AND AVIATION PARTS, U.S. EXPORTERS WERE ABLE TO OUTDO THEIR FOREIGN RIVALS IN TERMS OF INCREASING SALES.

17. (U) IN REVIEWING THE DATA, IT IS IMPORTANT TO BE AWARE THAT THE OCCURRENCE (OR NON-OCCURRENCE) OF SEVERAL HIGH-VALUE ADDED SALES IN A SPECIFIC YEAR COULD DISTORT THE EXPORT TOTALS FOR THAT YEAR. FOR INSTANCE, TURNING BACK TO USDOC FIGURES, ONE HTS CATEGORY WHERE THIS MIGHT TAKE PLACE, MIGHT BE "AIRCRAFT, SPACECRAFT AND PARTS THEREOF." HOWEVER, LOOKING AT THE FIVE BEST YEARS FOR U.S. EXPORTS UNDER THIS LINE ITEM (2001 - \$1.569 BILLION, 2002 - \$1.236 BILLION, 2004 - \$1.274 BILLION, 1999 - \$.954821 BILLION, AND 1998 - \$.910094 BILLION), IN THREE OF THOSE YEARS TOTAL U.S. EXPORTS DECLINED AS COMPARED TO THE YEAR BEFORE.

18. (SBU) THE DIFFICULTY OF DOING BUSINESS IN BRAZIL MAY BE ONE REASON BEHIND THE SPOTTY PERFORMANCE OF U.S. EXPORTS. FOR INSTANCE, A RECENT STUDY PREPARED BY THE MINISTRY OF DEVELOPMENT, INDUSTRY, AND COMMERCE CONCLUDES THAT BRAZIL'S PORTS ARE OPERATING AT VERY NEAR THE SATURATION POINT. EVEN AT BRAZIL'S MOST EFFICIENT PORTS, THE COSTS OF MOVING CARGO ARE SIGNIFICANTLY HIGHER THAN THOSE IN MANY INDUSTRIAL COUNTRIES. MEANWHILE, A DIZZYING ARRAY OF TAXES, FEES, AND OTHER SURCHARGES (A NUMBER OF THEM CASCADING, I.E., INCLUDING OTHER TAXES IN THE CALCULATION BASE) CAN MAKE FINAL PORT COSTS UP TO 70 PERCENT HIGHER THAN FREE ON BOARD PRICES. SOMETIMES IT TAKES LOCAL LEGAL REPRESENTATION TO MANEUVER THROUGH THE INTRICATE MAZE OF REGULATIONS, WHICH, OF COURSE, ONLY DRIVES UP IMPORT COSTS EVEN MORE. NOTWITHSTANDING THE DIFFICULTIES INHERENT IN EXPORTING TO BRAZIL, THIS CANNOT FULLY EXPLAIN THE LAGGING U.S. EXPORTS - AFTER ALL, ASIAN AND AFRICAN EXPORTERS FACE THESE SAME PROBLEMS AND THEIR SALES TO THE BRAZILIAN MARKET ARE INCREASING.

19. (U) THE SILVER LINING TO THIS CLOUD IS THE PERFORMANCE OF U.S. EXPORTS FROM SMALL AND MEDIUM-SIZED ENTERPRISES (SME), WHICH OVER A TEN-YEAR TIME PERIOD HAVE REGISTERED

SOLID GROWTH. SPECIFICALLY:

-- U.S SME EXPORTS TO BRAZIL INCREASED IN VALUE BY 242 PERCENT FROM 1992 TO 2001. IN US DOLLAR TERMS, THE INCREASE VALUE WAS NEARLY US\$2.65 BILLION.

-- OVER THIS SAME TIME-PERIOD, THIS 242 PERCENT GROWTH MADE BRAZIL THE FASTEST GROWING MARKET FOR U.S. SME EXPORTS IN THE WORLD. MEASURED BY THE US DOLLAR GAIN (US\$2.65 BILLION), BRAZIL RANKED SEVENTH IN THE WORLD.

-- MEANWHILE, IN 2001, 26 PERCENT OF U.S. EXPORTS TO BRAZIL CAME FROM SMES.

THE EFFORTS EXERTED BY THE U.S. COMMERCIAL SERVICE OF THE DEPARTMENT OF COMMERCE ON BEHALF OF U.S. SMES ARE ONE OF THE CHIEF REASONS BEHIND THIS INCREASE IN SME EXPORTS TO BRAZIL. IT IS ESTIMATED THAT THE U.S. COMMERCIAL SERVICE HAS ASSISTED OVER 200 COMPANIES PER YEAR FOR THE LAST TEN YEARS IN ENTERING THE BRAZILIAN MARKET (INCLUDING 281 IN 2003 AND 171 IN 2004.) THIS IS IN ADDITION TO HELPING COMPANIES ALREADY EXPORTING TO BRAZIL TO INCREASE THEIR SALES (I.E., 272 IN 2003 AND 371 IN 2004.) OTHER U.S. SMES COME TO MARKET THEIR WARES AT THE DOZENS OF REPUTABLE INTERNATIONAL SHOWS IN SAO PAULO AND OTHER BRAZILIAN BUSINESS CENTERS.

10. (SBU) RECENTLY PRESIDENT LULA HAS THREATENED TO ENCOURAGE GREATER IMPORTS IF LOCAL BUSINESS DOES NOT HOLD THE LINE ON PRICE INCREASES. WHILE, IN OUR VIEW, THE GOB IS PRINCIPALLY USING THE PRESIDENT'S STATEMENTS AS A DEVICE TO JAWBONE THE BUSINESS COMMUNITY INTO HELPING HOLD THE LINE ON INFLATION, IT WOULD BE A MISTAKE TO ASSUME THAT HE WILL NOT ACT IF HE HAS TO. INDEED, ON MARCH 4, AT FINANCE MINISTER PALOCCI'S REQUEST, LULA ZEROED OUT TARIFFS ON IMPORTS OF 15 TYPES OF STEEL PRODUCTS, GIVEN THE RECENT SERIES OF PRICE INCREASES SPARKED BY SURGING WELL DEMAND. (REFTEL A).

11. (SBU) HAVING MADE CLEAR THAT, IN SPECIFIC CASES WHERE NECESSARY, HE WILL MAKE GOOD ON HIS THREAT, LULA IS NOW FREE TO RELENT ON THE IDEA OF SLASHING TARIFFS ACROSS-THE-BOARD -- ESPECIALLY SINCE DOING SO MIGHT ERODE THE BALANCE OF TRADE AND CURRENT ACCOUNTS SURPLUSES THAT THE GOB HAS WORKED SO HARD TO ACHIEVE. THE 2004 CURRENT ACCOUNT (US\$11 BILLION) AND TRADE (US\$33.6 BILLION) SURPLUSES HAVE HELPED IMPROVE BRAZIL'S REPUTATION WITH BOTH INTERNATIONAL MARKETS AND THE CREDIT RATING AGENCIES, AND HAVE PROVED A READY SOURCE FOR FINANCING DOLLAR-BASED LOANS. IT IS UNLIKELY THAT THE GOB WILL END UP BITING THE HAND THAT FEEDS IT.

DANILOVICH